APPENDIX A

THE STATE OF SOUTH CAROLINA
In the Supreme Court

NCR CORPORATION,
Appellant,

v.

SOUTH CAROLINA TAX COMMISSION,
Respondent.

Appeal From Richland County
Thomas L. Hughston, Jr., Judge

Opinion No. 23969
Heard November 17, 1993—Filed December 13, 1993

AFFIRMED

John C. von Lehe, Jr., and Stephen P. Groves, of Young, Clement, Rivers & Tisdale, of Charleston and William L. Goldman, of Lee, Toomey & Kent, of Washington, D.C., for appellant.

Chief Deputy Attorney General Ray N. Stevens, and Assistant Attorney General Sarah G. Major, both of Columbia, for respondent.

MOORE, A.J.: Appellant (NCR) commenced this action to recover $499,007 in corporate income tax and

license fees paid under protest for the years 1981-83. At issue is the apportionment formula used to determine how much of NCR's unitary business income is taxable in South Carolina. We affirm.

FACTS

NCR is a world-wide corporation with several foreign subsidiaries. Respondent (Tax Commission) determined NCR's total income to include royalties and interest income NCR received from its foreign subsidiaries. NCR objected to the inclusion of this income because Tax Commission did not factor into the apportionment formula the contribution of the foreign subsidiaries in generating that income. The trial court affirmed Tax Commission's ruling.

In *NCR Corporation v. South Carolina Tax Comm'n,* 304 S.C. 1, 402 S.E.2d 666 (1991) (*NCR I*), we remanded this case to the trial court with specific instructions to: (1) recompute NCR's taxable income by factoring into the apportionment formula the proportionate contribution by foreign subsidiaries in generating NCR's income; (2) determine NCR's tax liability accordingly; (3) compare this new calculation to the tax liability actually imposed. If there was a "gross disparity" between these two amounts, NCR would be entitled to a refund. The basis of this holding was that NCR's due process rights would be violated if the apportionment formula as applied resulted in a tax liability that was grossly disproportionate to the income generated in South Carolina.

On remand, the trial court recomputed NCR's tax liability, determined there was no gross disparity, and concluded NCR was not entitled to a refund. NCR again appeals.

ISSUES

1. Whether the trial court properly recomputed NCR's taxable income?

2. Whether the tax imposed is grossly disproportionate to the income attributable to South Carolina?

DISCUSSION

A.

Under S.C. Code Ann. §§ 12-7-1120 through -1170 (1976 and Supp. 1992), the applicable apportionment formula uses three factors: property, payroll, and sales. Each factor is reduced to a fraction by using as the numerator the amount of that factor attributable to South Carolina and using as the denominator NCR's total amount of that factor. The three factors are then averaged and the resulting fraction, expressed in a percentage, is multiplied by NCR's total business income to determine the amount of income apportioned to South Carolina for taxation. *See NCR I*, 304 S.C. at 4, 402 S.E.2d at 668.

In *NCR I*, we determined that the denominator of this fraction did not have to include the *total* sales, property, and payroll of NCR's foreign subsidiaries because subsidiaries and their corporate parents are separate entities. 304 S.C. at 6, 402 S.E.2d at 669. On remand, however, the trial court was directed to determine the *proportion* of sales, property, and payroll of foreign subsidiaries used to generate the royalties and interest paid to NCR.

The trial judge used a pro rata method to calculate the proportion of sales, property, and payroll of foreign subsidiaries to be included in the denominator of the apportionment formula. He took the amount of royalties and income interest paid by a foreign subsidiary to NCR, divided it by that subsidiary's total income, and multiplied the resulting fraction by the total sales, property, and payroll of the subsidiary. This proportion of each subsidiary's sales, property, and payroll was then added to the denominator of the apportionment formula and NCR's taxable income was determined accordingly.

NCR does not contest the basic method of calculation but challenges two steps in the computation. First, it contends a subsidiary's total income should exclude foreign taxes paid. Second, it contends the calculation should not be done separately for each subsidiary but rather the proportion of sales, property, and payroll should be calculated by adding the totals from all the subsidiaries together.

1. *Should a subsidiary's total income exclude foreign taxes paid?*

NCR contends that in computing the proportion of sales, property, and payroll of foreign subsidiaries to be included in the denominator of the apportionment formula, the subsidiary's net income should be reduced by the amount of foreign income tax paid. We disagree.

As Tax Commission correctly points out, S.C. Code Ann. § 12-7-700(4) (1976) does not allow a deduction to net income for income taxes paid when computing taxable income.[1] Since a foreign subsidiary's net income is determined with the ultimate goal of inserting it into the apportionment formula in order to compute NCR's taxable income, no deduction should be allowed for foreign income taxes paid by a subsidiary.

2. *Should the proportionate contribution of sales, property, and payroll of foreign subsidiaries be computed on a combined basis or individually?*

NCR contends the royalties and interest income paid by all of its forty-four foreign subsidiaries should be combined and then divided by the combined income of all the subsidiaries to determine the proportionate contribution of sales, property, and payroll by foreign subsidiaries. Using this method of calculation, the gains of various subsid-

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[1] This section was repealed for tax years after December 31, 1984. Thereafter, S.C. Code Ann. § 12-7-430(d)(1) (Supp. 1992) applies with the same result.

iaries would be offset by the losses of others. Tax Commission, on the other hand, contends the trial court correctly made the calculation separately for each subsidiary and added each separate amount to the denominator of the apportionment formula.

We find Tax Commission's method of calculation is the better approach since it is consistent with general tax principles. Subsidiaries are treated as separate entities for tax purposes. *NCR I.* Combining NCR's forty-four subsidiaries would in effect be treating them as if they exist only in relation to NCR. The trial judge correctly made the calculation for each subsidiary separately.

In conclusion, the trial judge properly calculated the proportion of sales, property, and payroll of foreign subsidiaries to be added to the denominator of the apportionment formula. Pursuant to our directive in *NCR I*, the question then becomes whether there is a gross disparity of constitutional proportion between the resulting tax liability calculated under the new formula and the tax liability actually imposed.

B.

In *NCR I*, NCR challenged the apportionment formula on the ground it violates due process because it results in an unfair apportionment of income to South Carolina.[2] This Court held NCR had the burden to show application of the apportionment formula has led to "a grossly distorted result." *NCR I*, 304 S.C. at 11, 402 S.E.2d at 672. In so holding, this Court relied on *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545 (1983), which upheld California's three-factor apportionment formula against a due process challenge.

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[2] In the framework of a due process analysis, this argument is considered a challenge to the "external consistency" of the apportionment formula. *See Container Corp., infra*, 103 S.Ct. at 2942.

The fact that application of an apportionment formula results in an imperfect measure of apportioned unitary income does not prove a violation of due process. *Amerada Hess Corp. v. Director, Division of Taxation*, 490 U.S. 66, 109 S.Ct. 1617, 1622, 104 L.Ed.2d 58 (1989). In *Container Corp.*, the United States Supreme Court found application of California's three-factor formula withstood a due process challenge because the margin of error was "within the substantial margin of error inherent in any method of attributing income among the components of a unitary business." 103 S.Ct. 2950. The Court noted application of the three-factor formula resulted in only a 14% increase in taxable income when compared to the accounting method espoused by the taxpayer and concluded the taxpayer had failed to meet its burden of showing a due process violation.

This Court followed the *Container Corp.* analysis as applied by the Maryland Court of Appeals in *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988), and remanded this case for a determination of the amount of the disparity between the tax assessment calculated under the apportionment formula and the tax assessment calculated with the proportion of sales, property, and payroll of foreign subsidiaries factored into the denominator of the formula. The trial judge found an average difference of 27.9% for the three tax years in question. He concluded this margin of error indicated no gross disparity in NCR's apportioned income calculated under the apportionment formula and held there was no due process violation.

As already noted, the United States Supreme Court found the 14% margin of error in *Container Corp.* acceptable and specifically compared it to the 250% difference it found unacceptable in a due process challenge to a single-factor formula in *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 51 S.Ct. 385, 75 L.Ed. 879 (1931). Other state courts have upheld similar or

larger margins of error. *See Citizen's Utilities Co. v. Dept. of Revenue*, 94 Ill. Dec. 737, 111 Ill.2d 32, 488 N.E.2d 984 (1986) (213%); *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989) (23%). We find no gross disparity in this case and hold the apportionment formula as applied by Tax Commission results in no due process violation.

AFFIRMED.

HARWELL, C.J., CHANDLER, FINNEY and TOAL, JJ., concur.

APPENDIX B

STATE OF SOUTH CAROLINA)
)
COUNTY OF RICHLAND)

IN THE COURT OF COMMON PLEAS
FIFTH JUDICIAL CIRCUIT

Case No. 88-CP-40-1053

NCR CORPORATION,
Plaintiff,
-versus-
SOUTH CAROLINA TAX COMMISSION,
Defendant.

SUPPLEMENTAL ORDER ON REMAND

[Filed July 15, 1992]

This matter is before me based upon a Motion by the Plaintiff, NCR Corporation, to Alter or Amend Judgment. The Motion was timely filed following the issuance of an Order by me which was entitled the Order on Remand.

The purpose of the Motion to Alter or Amend Judgement was to invite this Court to consider an argument which NCR raised during the trial on remand of this case, but which NCR believes was not addressed by me in the Order on Remand.

There is disagreement among the parties concerning the meaning of the Motion and what argument NCR believes the Court did not address. The Tax Commission has interpreted NCR's Motion as presenting only the argument that any distortion regardless of size renders

the State's apportionment formula unconstitutional. NCR argues that the Tax Commission has mischaracterized its Motion. Based on the failure of the apportionment formula to take into account any of the payroll, property, or sales of NCR's foreign subsidiaries, and the resulting distortion (which I determined to be 27.9% for the three years in question), NCR states that it has "clearly placed before this Court its argument that the formula is inherently unfair, inevitably results in taxation of substantial extra-territorial values on an ongoing basis and that a conceptually flawed formula which would collect 27.9% too much tax every year, year after year, on a permanent ongoing basis is violative of the due process clause." (Plaintiff's Memorandum of Law, p. 2).

In order to avoid a dispute during the appeal of this case concerning the scope of NCR's Motion, I have considered all of the arguments presented by NCR. It is my opinion, after having examined all of these arguments, that the arguments are not persuasive of NCR's position that the State's apportionment formula is unconstitutional. It therefore remains the opinion of this Court that NCR is not entitled to a refund and that the assessment originally set by the Tax Commission is proper;

AND IT IS TO [SIC] ORDERED

/s/ Thomas L. Hughston, Jr.
THOMAS L. HUGHSTON, JR.
Presiding Judge
Fifth Judicial Circuit

Greenwood, South Carolina

Dated: July 11, 1992.

APPENDIX C

STATE OF SOUTH CAROLINA)
)
COUNTY OF RICHLAND)

IN THE COURT OF COMMON PLEAS

Case No. 88-CP-40-1053

NCR CORPORATION,
Plaintiff,

vs.

SOUTH CAROLINA TAX COMMISSION,
Defendant.

ORDER ON REMAND

[Filed November 26, 1991]

I. INTRODUCTION

On February 4, 1991, the South Carolina Supreme Court issued its Opinion in the case of *NCR Corporation v. South Carolina Tax Commission*, —— SC ——, 402 S.E.2d 666 (1991). There the court was confronted with a challenge to South Carolina's method of taxing royalty and interest income when such income was alleged by the taxpayer to have a foreign source. NCR challenged South Carolina's method by asserting that taxing such income violated the statutory requirements of South Carolina, the Foreign Commerce Clause requirements, and the Due Process Clause requirements. The Trial Court found no violations.

The Supreme Court affirmed the Trial Court in finding no violation of any South Carolina statute and in finding no violation of the Foreign Commerce Clause. The court, without intimating that the Trial Court's conclusion was in error, did believe, however, that the due process issue could best be examined by having the Trial Court further develop the issue. As a result, the Court directed the case be remanded to the Trial Court, and on April 22, 1991, Chief Justice Gregory vested jurisdiction in this court to hear the remand of this case.

II. ISSUE ON REMAND

A. *Background*

The due process challenge presented on remand concerns including in NCR's apportionment factors a portion of the payroll, property, and sales of NCR's royalty and interest paying subsidiaries. NCR asserts that its rights to due process are violated if South Carolina on one hand taxes NCR on the royalties and interest paid to it by its foreign subsidiaries while on the other hand, not including in its apportionment ratio the payroll, property, and sales of the subsidiaries that paid the income. When such issue was presented to this Trial Court during the initial trial of this matter, NCR asserted that to satisfy due process, 100% of the subsidiaries' payroll, property, and sales was required to be added to its apportionment ratio. The Tax Commission asserted that due process was satisfied without including any of the subsidiaries' payroll, property, and sales in NCR's factors since South Carolina was not taxing any of the subsidiaries' income. Rather, South Carolina was taxing only the income of the parent (NCR) and all of NCR's payroll, property, and sales were included in the apportionment factors.

Thus, the two sides in the initial trial of this case were on opposite extremes with NCR arguing that due process demanded the inclusion of 100% of the subsidiaries' pay-

roll, property, and sales, while the Tax Commission asserted none was to be included. Such conflicting views set the background for the issue now on remand.

B. *Due Process and Factor Relief*

The Supreme Court examined the due process issue and for purposes of the remand, gave the parties and this Court guidance in two areas. The first dealt with the burden of proof and the second with the method for the Trial Court to use in testing the formula in light of the Due Process requirements.

1. *Burden of Proof*

The burden of proving that the formula violates due process is on the taxpayer.

> At bottom, in order to prove a violation of due process, a taxpayer must clearly and cogently prove the apportionment formula, as applied, "has led to a grossly distorted result" or that "the income attributed to the state is in fact out of all proportion to the business transacted . . . in that State." (cite omitted)

NCR v. South Carolina Tax Commission, supra, at p. 672.

The court found that it was unable to determine from the record whether the exclusion of the subsidiaries' payroll, property, and sales from NCR's factors resulted in the taxing of an amount of income which was disproportionate to the business transacted in South Carolina. Because it was unable to determine the degree, if any, of disproportionality, the Court gave specific guidelines to be followed on remand to address this issue.

2. *Statement Of Trial Court's Duties*

In conducting the remand, the Court identified the tasks for the Trial Court to accomplish.

> . . . we remand this case to the lower court for a re-factoring of the formula, considering in the formula denominator the proportionate measure (as determined by the trial court led by the broad guidelines set out in this opinion) of the foreign subsidiaries' property, payroll, and sales which generated the NCR income. Once this is done, the new tax amount should be figured and compared with the tax amount presently assessed against NCR by the Tax Commission. If the trial court finds there is a gross disparity between the two amounts of constitutional proportions, it shall order the new tax amount to be assessed and refund granted. If no gross distortion exists upon a comparison of the tax amounts, the original tax assessed against NCR shall stand and NCR shall not be entitled to any refund.

NCR v. South Carolina Tax Commission, supra, at p. 674.

This language essentially assigns four tasks to this court. First, re-factor the formula; second, compute the new tax; third, compare the new tax to the old tax; and finally, decide if a gross disparity "of constitutional proportions" exists between the new tax and the old tax.

C. *Performing The Trial Court's Duties*

1. *Re-factoring the Formula*

Re-factoring the formula is accomplished by adding to NCR's factors that portion ". . . of the foreign subsidiaries' property, payroll, and sales which generated the NCR [royalty and interest] income." The parties have approached this requirement in different fashions. NCR has employed two methods (the Intangible Method and the Pro Rata Method) while the Tax Commission has presented one approach (the Pro Rata Method). This court finds that the Intangible Method is an inappropriate method for accomplishing the re-factoring but that the

Pro Rata Method is, when properly applied, a suitable choice.

a. *The Intangible Method Is Improper*

The Intangible Method advanced by NCR seeks to establish that the royalty and interest income can be directly traced as being earned by the payroll, property and sales of each subsidiary that produced that income. The court finds this is a faulty premise.

The idea that one can trace the royalty and interest income to the subsidiaries' payroll, property and sales must be based on the view that in some fashion these factors actually produced the royalty and interest income. This court finds that view unrealistic. In fact, NCR itself did not suggest a tracing method for connecting the payroll of a subsidiary to the royalty or interest produced by that subsidiary. Rather, to compensate for this lack of tracing, NCR used the Pro Rata Method to determine the amount of the subsidiaries' payroll to be added to NCR's payroll. Thus, as to the payroll factor NCR does not use a tracing method at all but rather employs the Pro Rata Method.

Further, the tracing method used by NCR for the property factor is improper under our existing statutes and produces an anomaly. NCR's "tracing" method increased the property factor of NCR by adding the intangibles that produced the royalty income (i.e. the investments in the trademarks and patents) and the intangibles that produced interest income (i.e. the investments in the notes). Such is specifically prohibited by S.C. Code Ann. § 12-7-1150 (1976) since the property factor by statute consists of only tangible property. The method suggested by NCR creates an anomaly in that NCR itself is forbidden by § 12-7-1150 (1976) from adding its intangible property to its own factors and yet the method suggested by NCR allows NCR to do precisely what the statute forbids. This court cannot adopt such a view. Rather,

the court finds the pro rata method more accurately accomplishes the required re-factoring.

b. *The Pro Rata Method Is Proper*

Both parties have employed a pro rata approach. The pro rata approach is based on determining the ratio of the total royalties and interest generated by the subsidiaries to the total of all incomes produced by the subsidiary. In other words, the royalty income plus interest income over the total of all incomes produced by the subsidiaries with such incomes consisting of the royalty income paid to NCR, the interest income paid to NCR and the subsidiaries' own net income. The ratio is then converted to a percentage that is multiplied by the payroll, property and sales of the subsidiary. This computation yields an additional amount of payroll, property and sales that is added to NCR's factors. Under this method, a portion of the subsidiaries' factors is included in NCR's factors.

Having found the Pro Rata Method is a reasonable method of re-factoring, the court further finds from the evidence and testimony that the approach employed by the Tax Commission is more appropriate to accomplishing the re-factoring than is the pro rata approach suggested by NCR. Each approach is discussed in this Order.

c. *Application Of The Pro Rata Method*

The court agrees with the Tax Commission that the subsidiaries generate three categories of income relevant to this dispute: interest income to NCR, royalty income to NCR, and finally, the net income of the subsidiaries themselves. The interest income and the royalty income here in dispute are income of NCR which is taxable by South Carolina while the net income of the subsidiaries is not taxable by South Carolina. The property, payroll and sales factors apparently were used to generate all three classes of income. Thus the re-factoring should only increase NCR's factors by that percentage of the

subsidiaries' factors that produce the income taxable by South Carolina. In short, the portion of the subsidiaries' factors that produced its own non-taxable net income should not be added to NCR's factors.

To decide what percentage of the factors generates the interest and royalty income which is taxed by South Carolina, a computation must be made. First, a fraction is created with the total income (royalty income plus interest income plus subsidiaries' net income) being the denominator and royalty income plus interest income being the numerator. Under this approach, a computation is made in which the percentage given by this fraction is multiplied by the payroll, property, and sales of the subsidiaries. The resulting amounts of payroll, property and sales are then added to NCR's factors to arrive at the re-factored payroll, property and sales used to generate the income taxed by South Carolina.

Under this approach, the denominators of the payroll, property, and sales ratios of NCR, the parent, are increased by adding to such denominators the appropriate percentages of each of the subsidiaries' payroll, property, and sales. When this is done, the ratio is re-factored, consistent with the Supreme Court's instructions, by using the proportionate share of the subsidiaries' payroll, property, and sales which generated the royalty and interest income. In applying the Pro Rata Method, NCR differed in two respects from the method being applied by this court. First, NCR seeks to reduce the net income of the subsidiaries by the foreign income tax paid. Second, NCR makes its computation of net earnings by combining all of the subsidiaries into one net earnings amount, while the court calculates each subsidiary's net earnings separately. The Court finds NCR's approach is in error and such is addressed here.

i. No Deduction Is Permitted For Foreign Income Taxes Paid

In order to determine what percentage of the subsidiaries' payroll, property, and sales generated the royalty and interest income here in dispute, the total of all income produced by those factors must be computed. Other than the royalty and interest income, the subsidiary produced its own net income as well. Thus, to compute the total income produced, it is necessary to determine the net income of the subsidiary.

NCR believes that foreign income taxes paid are deducted from the net income of the subsidiaries. This court finds that NCR's method of reducing the subsidiaries net income by the foreign income taxes is in error.

It must be remembered that the dispute arose in this action based on NCR's view that it was unfair to tax all of the foreign royalties and interest unless all of the payroll, property, and sales of the subsidiaries were included in NCR's factors. This court held in its previous order that including all of the subsidiaries' factors was incorrect since South Carolina did not tax any of the subsidiaries' net income, and therefore, it would be improper to include factors from entities over which South Carolina had no ability to tax.

Such a view is especially proper when re-factoring since the purpose of the re-factoring is to determine what portion of the subsidiaries' factors generated South Carolina taxable income. Consistent with that view, this court holds that it is improper to include in the re-factoring any portion of the subsidiaries' factors that generates net income that South Carolina is unable to tax. Thus to determine the correct amount of income for purposes of the re-factoring computation, the net income of the subsidiaries must be the taxable net income that South Carolina is unable to tax.

Further, not to use taxable net income would be improper since the computation would then be based on

combining inconsistent items. On one hand, the royalty and interest income amounts are taxable income, but the net income figures suggested by NCR would not be. NCR's approach does not arrive at income subject to tax and thus must be rejected.

In determining income subject to tax, South Carolina does not allow a deduction for foreign income taxes paid. (See S.C. Code Ann. § 12-7-700(4) (1976) denying a deduction for taxes on income, measured by income, or with respect to income; also see S.C. Code Ann. § 12-7-430(d)(1) (Supp. 1990) denying deductions for income taxes or any taxes measured by or with respect to net income.) Accordingly, in determining the income generated by the subsidiaries, no deduction is allowed for foreign income taxes paid. Thus, NCR's method not only adds numbers which are incompatible in that some are taxable income figures while others are not, but also NCR's method uses net income after deducting taxes. NCR's approach is closer to the subsidiaries' financial accounting income which obviously is not controlling for tax purposes.

ii. The Subsidiaries Must Be Treated Separately Rather Than As A Single Unit

NCR also combines all of the subsidiaries into a single unit for purposes of the re-factoring computation. Such a procedure is improper. The question on remand is what percentage of the payroll, property, and sales of each royalty and interest paying subsidiary is to be added to the factors of NCR. There are numerous subsidiaries paying royalties and interest, and each is a separate corporate entity generating its own income and its own expenses. In fact, the corporations are generally associated with a specific country and, while there are some transactions between subsidiaries, the dealings between corporations are inconsequential for purposes of this action.

In light of these findings, the court holds that it is improper to compute the net income of the subsidiaries

as one combined total. To do so allows the loss of one subsidiary to be applied to the positive net income of a separate subsidiary. For example, in 1981, the subsidiary in Argentina had a loss of $42,058,112. This loss is available, under NCR's approach, as an offset to the positive net income of numerous corporations without sufficient basis justifying the offset. For example, such loss as used by NCR has the effect of offsetting the positive net income of such distinctly profitable corporations as are listed below:

Australia	$ 4,843,521
Belgium	3,339,646
Iraq	110,596
Mexico	5,061,080
New Zealand	785,739
Puerto Rico	751,779
Switzerland	16,978,269
United Kingdom	9,035,302
Zwimbabwe [sic]	1,151,845

The process of using the losses from some subsidiaries to offset the income of profitable subsidiaries under NCR's approach results in a "combined" profit of all subsidiaries for 1981 of only $10,541,743. Such is an inaccurate representation of the actual business of each corporation.

The court finds that the net income of each subsidiary should be computed separately. Thus, each subsidiary has an amount shown for royalty income produced, interest income produced, and for that subsidiary's net income produced. Once these three amounts are totalled, the percentage of the total represented by the royalty and interest income is computed. This percentage is then used to determine how much of that subsidiary's factors are to be added to NCR's factors. This method is the manner in which the Tax Commission has applied the Pro Rata Method.

It is the conclusion of this court that the Tax Commission's approach is the correct one. Such approach

does not distort the net income of the subsidiaries by artificially shifting losses from one subsidiary to another. Further, and as explained above, the Tax Commission's method correctly denies a reduction of the subsidiaries' net income for foreign income taxes in determining the total amount supported by the payroll, property and sales of the subsidiaries.

Based on the Tax Commission's method, which this court approves, the following amounts are added to NCR's factors:

	1981	1982	1983
Property	$668,318,293	$388,123,864	$420,567,133
Payroll	252,669,129	127,076,814	144,031,029
Sales	831,120,410	567,809,097	657,656,007

By adding the above amounts to NCR's factors, the requirement of the Supreme Court to re-factor the ratio used by NCR is met. Such being accomplished, it is now this court's duty to compute the new tax resulting from the re-factoring.

2. *Computation Of The New Tax*

After re-factoring the ratios of NCR, as is done above, this court is required to compute the new tax based on the new ratios. The evidence shows that the new tax amounts, including the re-factoring, are as follows:

	1981	1982	1983
New tax	$138,001	$216,977	$344,948

3. *Compare Old Tax To New Tax*

The third task of this court is to determine the difference which results from comparing the old tax (the tax asserted by the Tax Commission in its assessment in which no provision is allowed for any of the payroll, property, or sales of the subsidiaries) to the new tax (the tax computed by using the new ratios generated by the re-factoring). The table below shows this comparison.

	1981	1982	1983
Old tax	$190,879	$264,541	$426,600
New tax	−138,001	−216,977	−344,948
Difference	52,878	47,564	81,652

Based on these computations, the act of not including a proportionate share of the payroll, property, and sales of the subsidiaries results in an increase in tax due by a taxpayer. That increase as a percentage of the new tax (i.e. including the re-factoring amounts) results in an increase in tax liability of the following percentages for each of the tax years here in dispute:

	1981	1982	1983
Difference	$ 52,878	$ 47,564	$ 81,652
New Tax	138,001	216,977	344,948
% of Increase	38.3%	21.9%	23.6%
Average Increase	27.9%		

The above computation identifies that for the years involved there was an average increase in tax of 28% due to not allowing NCR to employ any of the factors of the subsidiaries. Based on this percentage, this court is asked to examine on remand whether such an amount is a constitutional violation. This court finds there is no constitutional violation and this aspect is discussed below.

4. No Gross Disparity Is Present

The final task for this court is to decide if the difference between the original tax and the new tax constitutes ". . . a gross disparity between the two amounts of constitutional proportions." This gross disparity test is part of the fairness requirements of due process. Before examining the evidence concerning a "gross disparity" in the instant case, it is important to understand the background surrounding the proof necessary to establish the existence of a gross disparity.

The Due Process Clause requires satisfying a test commonly referred to as the external consistency test. This

test seeks to show that the apportionment factors "reflect a *reasonable* sense of how income is generated." (Emphasis added) *Container Corp.*, 463 U.S. at p. 169. In this formulation of the test, the Court underscores the view that the factors in the formula are only to be reasonable. Exactness is not a requirement and is not possible. In fact, to develop the view that rough approximations are valid, the *Container* Court identified the "gross disparity" test to set the outer limits of what is reasonable. 103 S.Ct. at p. 2942:

> . . . we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is, in fact, 'out of all appropriate proportions to the business transacted . . . in that State,' [*Hans Rees' Sons, Inc.*] 283 U.S. at 135, 51 S.Ct. at 389, or has 'led to a grossly distorted result,' [*Norfolk & Western R. Co. v. State Tax Comm'n.*, 390 U.S. 317, 326, 88 S.Ct. 995, 1001, 19 L.Ed.2d 1201 (1968)]." *Moorman Mfg. Co.*, supra, 437 U.S. at 274, 98 S.Ct. at 2345.

Our Supreme Court recognized that the factors are not required to be exact, but rather, are only required to be reasonable. In *Covington Fabrics v. South Carolina Tax Com'n.*, 264 S.C. 59, 212 S.E.2d 574, 577 (1975), the Court stated the following:

> Although exactness in apportionment is desirable, all that is required is a reasonable approximation.

A taxpayer, to show the existence of a gross disparity, must conclusively demonstrate that South Carolina's apportionment formula is unfair in due process terms. That this task, imposed on a taxpayer, carries a heavy and difficult burden of proof is fully supported by the United States Supreme Court in *Container,* supra.

> We turn now to the question of fair apportionment. Once again, appellant has the burden of proof; it

> must demonstrate that there is "no rational relationship between the income attributed to the State and the intrastate values of the enterprise," Exxon Corp., 447 U.S. at 220, 100 S.Ct. at 2118, quoting Mobil, supra, 445 U.S. at 437, 100 S.Ct. at 1231, by proving that the income apportioned to California under the statute is "out of all appropriate proportion to the business transacted by the appellant in that State," Hans Rees' Sons, Inc., 283 U.S. at 135, 51 S.Ct. at 389.

Container Corp., supra, 103 S.Ct. at p. 2948.

Thus, *Container*, supra, states that an apportionment method can be held improper only if the taxpayer demonstrates by clear and cogent evidence that the income attributed to the State is out of all appropriate proportions to the business transacted there or the formula leads to a grossly distorted result. It is this court's view that in the instant case South Carolina's formula does not lead to a grossly distorted result. In fact, this court finds that the re-factoring computation proves there is no gross distortion.

Gross distortion of a constitutional magnitude has been rare and the United States Supreme Court has been reluctant to conclude a formula created a gross distortion. In *Butler Bros. v. McColgan*, 315 U.S. 501 (1942), a three-factor formula apparently caused a 1500% increase in tax compared to the tax under the taxpayer's view. Despite this, the Court found the formula proper. It is significant to note that the United States Supreme Court has stricken only one apportionment formula because of distortion. In *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931), a 250% distortion created by a single-factor formula was held improper. Such a result is far removed from the instant case since here the well established three-factor formula is used by South Carolina and equally as significant is this court's

finding that on average there is an increase in tax of only 28%.

Other state courts have refused to strike down the three-factor formula in the face of alleged gross distortions. In Illinois in *Citizen's Utilities Co. of Illinois v. Dept. of Revenue,* 488 N.E.2d 984 (1986), an apparent 213% increase was not fatal. In *Westinghouse Electric Corp. v. Com. of Rev.,* 398 N.W.2d 530 (1986), the Minnesota court upheld the three-factor formula despite an alleged increase in tax of 300%.

It must be noted that even under the evidence produced by NCR and even assuming that NCR's methodology is correct (which this court has found to be incorrect) there is still no constitutional violation. NCR sought to establish that its highest percentage of distortion was 73% in 1981 and the average for the three years was 51%. Under the criteria of NCR having the burden of showing a "gross distortion" it is this court's conclusion that such has not been established.

The three-factor formula is always an approximation and cannot be overturned unless the evidence clearly shows that the state has taxed an amount beyond all reasonable relationship to the activities of the taxpayer in the taxing state. Here the source of the royalty and interest income cannot be placed as having been earned in any designated location. Rather, the activity of NCR is that of a unitary business and the source or location of any of its income simply cannot be determined. That is in fact the very reason the three-factor formula is appropriate and it is this court's view that the formula is within the constitutional limitations of Due Process.

III. CONCLUSION

Accordingly, this court finds that after re-factoring the apportionment formula, South Carolina has not taxed the income of NCR beyond the limits set by the Due

Process Clause of the Constitution. It is the order of this court that NCR is not entitled to a refund and that the assessment originally set by the Tax Commission is proper.

AND IT IS SO ORDERED.

/s/ Thomas L. Hughston, Jr.
THOMAS L. HUGHSTON, JR.
Presiding Judge
Fifth Judicial Circuit

Nov. 26, 1991.

APPENDIX D

STATE OF SOUTH CAROLINA
In The Supreme Court

NCR CORPORATION,
Appellant,

v.

SOUTH CAROLINA TAX COMMISSION,
Respondent.

Appeal from Richland County
Thomas L. Hughston, Jr., Judge

Opinion No. 23328

Heard October 23, 1990—Filed February 4, 1991

AFFIRMED IN PART AND REMANDED

John C. von Lehe, Jr. and Stephen P. Groves, both of Charleston; and William L. Goldman, of Lee, Toomey & Kent, of Washington, D.C., for appellant.

Deputy Attorney General Ray N. Stevens, of the South Carolina Tax Commission, of Columbia, for respondent.

TOAL, A.J.: This appeal involves an attempt by NCR Corporation ("NCR") to recover certain corporate income taxes and license fees paid under protest to the South Carolina Tax Commission ("Tax Commission"). The trial judge ruled that no refund should be given NCR. We affirm in part and remand.

FACTS

NCR is a multinational corporation engaged in the business of developing, manufacturing, marketing, installing, and servicing business information processing systems. All phases of NCR's businesses are conducted partly within and partly without South Carolina. In foreign countries, NCR conducts its business both directly through branch offices and through subsidiary corporations. During the years at issue (the 1981-1983 tax years) there existed approximately eighteen foreign branches and seventy-five foreign subsidiaries doing business in approximately one hundred fifty-nine countries. The foreign subsidiaries are owned 100% by NCR, with the exception of NCR's subsidiary in Japan, in which NCR has 70% ownership. These subsidiary companies have not conducted any business within South Carolina.

In conducting this worldwide business, NCR develops, acquires, owns, and uses patents and patent rights, both in the United States and in foreign countries. Also, NCR registers patents and licensing agreements in foreign countries pursuant to which NCR's foreign subsidiaries have the right to manufacture and sell business machines and equipment in those countries. These patent licensing agreements generate royalty income to NCR from the foreign subsidiaries. Further, NCR registers certain foreign loan agreements in foreign countries. It therefore receives interest income from the various loans it makes to the foreign subsidiaries. NCR also receives interest income from deposits it makes in foreign countries.

This royalty and interest income is itemized in NCR's federal income tax return as royalty and interest income earned in these foreign countries. Foreign countries in which NCR and its subsidiaries do business tax the net income of the subsidiaries. In addition, many of the countries impose an unapportioned tax on NCR on the full value of all royalty and interest amounts earned by NCR and paid to it by its foreign subsidiaries. A fed-

eral tax credit is granted to NCR for the royalty and interest income taxes paid to foreign governments.

The royalty income of NCR here in dispute is as follows:

1981	1982	1983
$32,996,316	$39,242,371	$49,992,119

The interest income of NCR here in dispute is:

1981	1982	1983
$18,304,080	$23,924,409	$16,562,396

South Carolina's corporate income tax is an apportioned income tax, through which South Carolina attempts to tax NCR's unitary business [1] income on roughly a percentage basis which is derived by comparing NCR's South Carolina business to the rest of its business. NCR's corporate income tax liability in South Carolina is determined by using a three-factor apportionment formula.[2] The factors are sales, property, and payroll. Each "factor" is reduced to a fraction. The numerator of the sales factor, for example, is the amount of NCR's South Carolina sales; the denominator of the sales factor is the amount of NCR's South Carolina sales combined with all other sales. The property and payroll factors are computed in the same manner. The three factors are averaged and the resulting fraction, expressed in a percentage, is multiplied by NCR's total business income. The resulting dollar amount is the business income properly apportioned to this state for taxation. The tax is then levied on this apportioned income. *See generally, Emerson Elec. Co. v. Wasson*, 287 S.C. 394, 339 S.E.2d 118 (1986).

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[1] All parties concede that NCR is engaged in an integrated unitary business nationwide and worldwide.

[2] *See* S.C. Code Ann. §§ 12-7-1120 - 12-7-1170 (1976 and Supp. 1989).

Here, the Tax Commission included in NCR's total income for tax purposes the royalty and interest income it received from its foreign subsidiaries. The Tax Commission did not include in its apportionment equation any of the foreign subsidiaries' sales, property or payroll. NCR argues that South Carolina may not tax it in this manner, since such a tax: (1) is contrary to statutory mandates; (2) violates the foreign commerce clause of the United States Constitution; and (3) violates the due process clause of the United States Constitution. NCR therefore seeks $499,007 by way of a refund of taxes paid under protest.

LAW/ANALYSIS

I. STATUTORY CONSTRUCTION

NCR contends we should interpret our statutory apportionment taxing scheme as requiring that foreign subsidiaries' payroll, property, and sales be included in the denominator of South Carolina's apportionment formula. NCR cites, by way of example, § 12-7-1150 (1989 Supp.), which contains the procedure to be used for determining the "property" factor. This statutory section provides, in pertinent part, for a:

> ratio of the average value of the real estate and tangible personal property, as defined in this section, used by such taxpayer in this State during the income year, to the average value of the entire real estate and tangible personal property, as defined in this section, used by the taxpayer *everywhere* during the income year . . . ." (emphasis added).

Similar verbiage is used in the statutory sections dealing with the sales and payroll factors. NCR points to the language such as "everywhere" in § 12-7-1150 and argues that its plain meaning mandates an inclusion of the foreign subsidiaries' sales, property, and payroll in the denominator of the fraction used to determine apportioned income.

It appears only one court has agreed with NCR's position in this regard. *See Kellogg Co. v. Herrington*, 216 Neb. 138, 343 N.W.2d 326 (1984). The *Kellogg* Court purported to apply statutory construction rules, including the "plain meaning" rule, in reaching the result NCR urges here. *Kellogg* has been criticized heavily as "mindless", and as "heedless" of clear legislative intent. *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989); *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (Ct. App. 1988).

Although the statutes indeed do include words aiding NCR's urged interpretation, those words must be read in context. Each of the statutory sections defining the ratios of property, payroll, and sales use the singular word "taxpayer". In *Emerson Elec. Co. v. Wasson*, 287 S.C. 394, 339 S.E.2d 118 (1986), we held parent and subsidiary corporations are not to be considered a single entity for purposes of § 12-7-1170. South Carolina is not taxing the income of NCR's subsidiaries, but instead only the income of NCR itself as a separate corporate entity. Consequently, subsidiary payroll, sales, and property also should generally not be considered under our statutory scheme.

We follow the holding of the Maryland Court in *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764, 777-78 (Ct. App. 1988), in which the court stated:

> it is the taxpayer's property, sales, and payroll values, in Maryland and in total or everywhere, that enter the formula. "The taxpayer" does not, of course, include the taxpayer's subsidiaries or their property, sales and payroll values, just as the subsidiaries' income is not included . . . .

We also rely upon the Minnesota Supreme Court's ruling in *NCR Corp. v. Commissioner of Revenue*, 438 N.W. 2d 86 (Minn. 1989), in which the Court held:

> Because NCR is the only "taxpayer" involved in this case, the apportionment statute contemplates that only its factors of property used, payroll paid, and sales made are relevant for inclusion in the denominator of the apportionment function. Therefore, NCR's construction argument must be rejected.

We likewise reject NCR's argument in this regard.

II. FOREIGN COMMERCE CLAUSE

NCR next argues that, since foreign countries have taxed the royalty and interest amounts in full, South Carolina may not do so since such would amount to a violation of the foreign commerce clause. The foreign commerce clause provides: "Congress shall have power . . . to regulate commerce with foreign nations, and among the several states, and with the Indian tribes." U.S. CONST. Art. I, § 8, cl. 3. NCR maintains the United States Supreme Court decision in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979) requires reversal of the trial court.

Japan Line dealt with an attempt by California to impose an *ad valorem* property tax on cargo containers, owed by Japanese companies, which were instrumentalities of foreign commerce and which were temporarily located in various California ports while *en route* to other destinations. The same containers were also subject to an unapportioned property tax in Japan. The *Japan Line* Court first set forth the test used in determining whether an impermissible burden on interstate commerce had resulted from the state tax, and established that test as a threshold challenge to be met by the state in foreign commerce clause tax cases. The Court stated: "[i]f the State tax 'is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State, no impermis-

sible burden on interstate commerce will be found." *Japan Line*, 441 U.S. at 444-45, 99 S.Ct. at 1819 (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326 (1977)).

The *Japan Line* Court next established that:

> An inquiry more elaborate than that mandated by *Complete Auto* is necessary when a state seeks to tax the instrumentalities of foreign, rather than of interstate, commerce. In addition to answering the nexus, apportionment, and nondiscrimination questions posed in *Complete Auto*, a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments." If a State tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause.

441 U.S. at 451, 99 S.Ct. at 1823. The Court proceeded to employ those two additional tests, and found that the California tax contravened both "precepts". Specifically, the Court found that California's tax in fact caused a "double tax"; and that a treaty entitled the "Customs Convention on Containers" existed between the United States and Japan, which stated that containers used exclusively in foreign commerce and "temporarily imported are admitted free of 'all duties and taxes whatsoever chargeable by reason of importation.'" 441 U.S. at 453, 99 S.Ct. at 1824 (quoting from 20 U.S.T. at 304). Hence, the Court reasoned, the actual double tax present violated prong one of the foreign commerce clause test, and the state tax in the face of the treaty contravened prong two—that the Federal Government must be able to speak with one voice.

Read in isolation, *Japan Line* appears to support NCR's position here. However, the case controlling the

situation here is not *Japan Line* in our view, but *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545 (1983). In *Container Corp.* the Court retreated from its broad *Japan Line* rules and in our view restricted *Japan Line* substantially. *Container Corp.* again involved a California tax. This time, however, the tax was an apportioned corporate income tax on Container Corporation, a company headquartered in Illinois but doing business in California as well as other states and countries. California imposed the same three-factor apportionment formula upon Container corporation as was here imposed by the Tax Commission on NCR.

The *Container Corp.* Court first addressed this formula method of taxation thusly:

> Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, "tax value earned outside its borders." In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. For this reason and others, we have long held that the Constitution imposes no single formula on the states, and that the taxpayer has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed. . . ."
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> . . . .
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> The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing

> jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. This Court long ago upheld the constitutionality [of this] method. . . .

463 U.S. at 164-65, 103 S.Ct. at 2939-40. (citations omitted). The Court went on to state that the three-factor formula used by California (and South Carolina here) not only met its approval but was "something of a benchmark against which other apportionment formulas are judged." 463 U.S. at 170, 103 S.Ct. at 2943.

In *Container Corp.*, California required Container Corporation, against its will, to include all foreign subsidiary income as part of its "unitary" business, and at the same time included in its calculations the foreign subsidiaries' property, payroll, and taxes. Container Corporation complained that the inclusion of the foreign subsidiary income in California's apportionment tax scheme violated the *Japan Line* case, since the foreign countries had already taxed the same income on an unapportioned basis.[3]

On this point the Court retreated from its *Japan Line* test. The Court first stated:

> [t]his case is similar to *Japan Line* in a number of important respects. First, the tax imposed here, like the tax imposed in *Japan Line*, has resulted in actual

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[3] The taxing scheme employed by the Tax Commission here differs from California's. California ignored corporate identities and included all foreign subsidiary income and all foreign subsidiary property, payroll, and taxes in its apportionment formula. South Carolina uses the "separate entity" method, in which corporate divisions are recognized. Either method is permissible as a general matter. *See Container Corp., supra*, 463 U.S. at 167-168, 103 S.Ct. at 2933. *Container Corp.* rejected the foreign commerce clause complaint of multiple taxation where the California method of ignoring corporate identities was involved; we reject the same argument here, where the separate entity method is used.

> double taxation, in the sense that some of the income taxed without apportionment by foreign nations as attributable to appellant's foreign subsidiaries was also taxed by California as attributable to the State's share of the total income of the unitary business of which those subsidiaries are a part.

Container Corp., 463 U.S. at 187, 103 S.Ct. at 2951-52. However, where actual double taxation appeared to end the inquiry in *Japan Line*, the *Container Corp.* Court stated "[n]evertheless, there are also a number of ways in which this case is clearly distinguishable from *Japan Line*." 463 U.S. at 187-88, 103 S.Ct. at 2952. The Court observed that the *Container Corp.* decision was distinguishable since: (1) the tax is on income rather than property; (2) the double taxation, although real, is not "inevitable" under the California taxing scheme; and (3) the tax falls on a domestic corporation, not a foreign owner of an instrumentality of foreign commerce.

The same distinguishing factors exist which make *Japan Line* inapplicable in the instant case. This is not a property tax case. We are unconvinced that double taxation is "inevitable" under the South Carolina taxing scheme. *See NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989) (holding the Minnesota separate entity taxing scheme employed there in an identical situation as here did not result in inevitable double taxation).[4] Further, the tax here falls on a domestic corporation, not a foreign company as in *Japan Line*.

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[4] Even if we were convinced the tax resulted in inevitable double taxation, we doubt, in light of the other facts clearly distinguishing this case from *Japan Line*, that the taxing scheme should be struck down. Indeed, the *Container Corp.* Court observed, "we specifically left open in *Japan Line* the application of that case to 'domestically owned instrumentalities engaged in foreign commerce' . . . and—to the extent that corporations can be analogized to cargo containers in the first place—this case clearly falls within that reservation." 463 U.S. at 188-89, 103 S.Ct. at 2952.

As to the second prong of *Japan Line*—that a state taxing scheme should not prevent the Federal Government from speaking with one voice—the test is "whether a state tax implicates foreign policy issues or violates a clear federal directive." *NCR Corp. v. Commissioner of Revenue, supra,* 438 N.W.2d at 94-95 (citing *Container Corp.,* 463 U.S. at 194, 103 S.Ct. at 2955). We reject NCR's contention that this prong of *Japan Line* is violated, as we perceive no clear Federal directive precluding the South Carolina Tax Commission's actions. "Whether any alleged increased tax liability affects federal foreign policy is, as observed by the Supreme Court of the United States, more appropriately addressed by other branches of the government." *NCR Corp. v. Commissioner of Revenue, supra,* 438 N.W.2d at 95.[5]

Thus, we reject NCR's foreign commerce clause argument, and hold that the method of taxation employed by the Tax Commission passes all constitutional tests in that regard. We next address NCR's due process contention.

III. DUE PROCESS

It cannot be doubted that "fairness is the test of due process constitutionality in the context of unitary business income taxation." *NCR Corp. v. Comptroller of the Treasury,* 313 Md. 118, 544 A.2d 764, 779 (Ct. App. 1988).

> [A]n apportionment formula must, under both the Due Process and Commerce Clauses, be fair . . . . The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed. The second and more difficult

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[5] We note that no treaty similar to that in *Japan Line* exists here which by its text prevents state taxation of NCR's foreign subsidiary royalty and interest income.

> requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing state. . . ."

Container Corp., 463 U.S. at 169-170, 103 S.Ct. at 2942 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272, 98 S.Ct. 2340, 2344, 57 L.Ed.2d 107, 204 (1978)) (citations omitted; emphasis in original).

At bottom, in order to prove a violation of due process, a taxpayer must clearly and cogently prove the apportionment formula, as applied, "has led to a grossly distorted result" or that "the income attributed to the state is in fact out of all proportion to the business transacted . . . in that State." *NCR Corp. v. Comptroller of the Treasury, supra*, 313 Md. 118, 544 A.2d at 779 (quoting *Container Corp.*, 463 U.S. at 170, 103 S.Ct. at 2942). NCR asserts that unfairness results from South Carolina's taxing scheme because no foreign subsidiary property, payroll, or sales are considered in the denominator of South Carolina's apportionment formula for determining NCR's percentage of business conducted in South Carolina, while at the same time income generated at least in part by those foreign subsidiaries is included in NCR's income subject to taxation. We have located three other state court decisions addressing this question.

In *American Tel. and Teleg. Co. v. Wisconsin Dept. of Rev.*, 143 Wis.2d 533, 422 N.W.2d 629 (1988), the Wisconsin Court of Appeals dealt with this issue. First the court noted that:

> Commentators, however, have recognized that future constitutional attacks on state taxation of unitary businesses may focus, as does A.T.&T.'s attack, on apportionment formulas which allegedly give insuffi-

> cient weight to the sales, property, and payroll of subsidiaries which make dividend, interest, royalty, and other payments to the parent corporation which are included by the taxing state as income subject to apportionment.

422 N.W.2d at 635. The court then stated, "[t]he simple but controlling question is whether the state (of Wisconsin) has given anything for which it can ask return." *Id.* at 636. Answering this rhetorical question, the court held,

> Wisconsin has given to A.T.&T. the privilege of carrying on business in the state. It has provided its Long Lines Department protection, governmental services and the benefits of orderly, civilized society. But the taxes which Wisconsin exacts from A.T.&T. are grossly disproportionate to the benefits conferred.
>
> . . . .
>
> [W]e conclude the apportionment formula used by the department does not reflect a reasonable sense of how A.T.&T.'s income is generated and taxes value earned outside the borders of Wisconsin . . . .

Id. at 636.

The opposite of this decision can be found in *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989). That case had virtually identical facts as the instant case. Finding that the increase in NCR's taxes from the application of the apportionment formula was 23% when compared to what NCR's taxes would be if a proportionate measure of the foreign subsidiaries' sales, property, and payroll were factored in, the Minnesota Supreme Court held that this distortion was not "outside the substantial margin of error" allowed, and was not grossly disproportional to the activity carried on in Minnesota by NCR. 438 N.W.2d at 93. The Minnesota Supreme Court pointed out the United States Supreme Court has ruled that a gross disparity existed when there was a 250% increase in tax, *see Hans Rees Sons, Inc. v. North*

Carolina, 283 U.S. 123, 51 S.Ct. 385, 75 L.Ed. 879 (1931), but that one does not exist when there was an increase of 14%. *See Container Corp., supra.* The Minnesota Court then concluded 23% was more like the *Container Corp.* decision than *Hans Rees Sons.*[6]

Finally, the Court of Appeals of Maryland also addressed this issue in *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (Ct. App. 1988). That case also involved very similar facts as the instant case. The Maryland Court first noted that "NCR is correct in asserting that the formula, as applied to it, does not produce ideally fair results . . . . The question becomes whether NCR has demonstrated that the existing distortion is so grossly disproportionate that it is unconstitutional." *Id.*, 544 A.2d at 780.

We agree with the reasoning of the Court of Appeals of Maryland. South Carolina's taxing scheme is not ideally fair. To a degree, the income received by NCR from its foreign subsidiaries was earned in the United States (and to an extent in South Carolina) as it was partly here where loan monies were created and patents developed and researched. Hence, domestic payroll, property, and sales which are related to producing this royalty and interest income (like domestic research and development companies) have already been included in the formula denominator. However, if the wholly owned foreign subsidiary did not exist, no royalty or interest income could be generated for NCR, obviously.

In this vein, the Maryland Court held, dealing with dividends rather than royalty and interest income:

> [i]t may not be unreasonable to suggest that inclusion of subsidiaries' dividends in the apportionable income [of NCR] should be balanced by some changes in the formula denominator. But the balancing should not

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[6] Obviously, taxing schemes producing such disparities, expressed in percentages, must be resolved on a case-by-case basis.

> be done by including the total property, sales, and payroll values. . . . Instead, the denominators should be modified by including only those percentages of the foreign subsidiaries' property, payroll, and sales that generated the foreign subsidiary dividend income taxed by Maryland.

Id., 544 A.2d at 781. We adopt the Court of Appeals of Maryland's reasoning that:

> we are unable to determine [from the record],[7] in any meaningful way, the extent to which a reasonably structured formula . . . might differ in its results from a formula which excludes that portion of the foreign subsidiary property, payroll, and sales which generated the dividend income. As a further consequence, we cannot tell whether disproportionality [a grossly distorted result] of constitutional proportions is present here.

Id.

Because the trial court did not adequately consider this disproportionality issue, we remand this case to the lower court for a re-factoring of the formula, considering in the formula denominator the proportionate measure (as determined by the trial court led by the broad guidelines set out in this opinion) of the foreign subsidiaries' property, payroll, and sales which generated the NCR income. Once this is done, the new tax amount should be figured and compared with the tax amount presently assessed against NCR by the Tax Commission. If the trial court finds there is a gross disparity between the two amounts of constitutional proportions, it shall order the new tax amount to be assessed and refund granted. If no gross distortion exists upon a comparison of the tax amounts, the original

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[7] This case is unlike *American Tel. & Teleg. Co., supra, NCR Corp. v. Commissioner, supra; Container Corp., supra*; and *Han* [sic] *Rees Sons, supra*, in which the courts were able to determine from the record whether a "grossly distorted result" was produced from the taxing scheme.

tax assessed against NCR shall stand and NCR shall not be entitled to any refund.

Accordingly, the judgment of the lower court is AFFIRMED IN PART AND REMANDED.

GREGORY, C.J., HARWELL, CHANDLER and FINNEY, JJ., concur.

APPENDIX E

STATE OF SOUTH CAROLINA)
)
COUNTY OF RICHLAND)

IN THE COURT OF COMMON PLEAS

Case No. 88-CP-40-1053

NCR CORPORATION,
Plaintiff,

-versus-

SOUTH CAROLINA TAX COMMISSION,
Defendant.

FINAL ORDER

[Filed Feb. 23, 1990]

An Order dated October 2, 1989, was previously issued by this Court as a Final Order in this matter. Following the filing of said Order, a motion under Rule 59 was made by NCR Corporation to alter or amend that Order. Upon consideration of the motion, the Court has determined that the prior Order of October 2, 1989, is withdrawn and the following Order is issued in its place as the Final Order by this Court.

This case came before this Court as the result of a dispute over South Carolina corporate income tax. After hearing the evidence and receiving extensive Briefs by both parties, this Court concludes the tax as assessed by the Defendant is proper and that no refund of any tax should be made.

FACTS

NCR is a multinational corporation whose business is the developing, manufacturing, marketing, installing, and servicing of business information processing systems. All phases of NCR's business are conducted in South Carolina. The West Columbia plant develops, manufactures, and markets NCR's line of Tower computers. NCR's plant in Liberty, South Carolina, manufactures personal computers, and NCR has several retail and service offices in South Carolina, including offices in Columbia and Greenville. Products produced in South Carolina are distributed and sold throughout NCR's worldwide market.

NCR received royalty income from its unitary foreign subsidiaries. The royalty income pertinent to this action is received from foreign subsidiaries pursuant to patent licensing agreements under which NCR authorizes the foreign subsidiary to manufacture and sell NCR's patented machines.[1] The foreign subsidiaries are owned 100% by NCR, with the exception of NCR's subsidiary in Japan which is owned 70% by NCR. Royalties received by NCR from its foreign subsidiaries were as follows:

1981	1982	1983
$32,996,316	$39,242,371	$49,992,119

NCR also received substantial interest income from its unitary foreign subsidiaries. Interest income pertinent to this action resulted from four areas: NCR's financing of its foreign subsidiaries' accounts receivable, NCR's direct loans to the foreign subsidiaries, funds generating interest identified as I.R.C., Section 904(d) interest, and NCR's

[1] NCR also received royalties from what it calls domestic sources as well. NCR's Exhibit 18 identifies domestic royalties as follows:

1981	1982	1983
$145,854	$129,437	$93,368

funds deposited in foreign countries.[2] Interest income from these areas was as follows:

1981	1982	1983
$18,304,080	$23,924,409	$16,562,396

Because NCR receives royalty and interest income from its activities in foreign countries, the various laws of those countries impose a withholding tax on such income. The withholding tax on royalty income and on interest income is as follows:

	1981	1982	1983
Royalties	$1,463,093	$1,729,928	$2,204,996
Interest	4,379,925	4,147,747	1,686,336

In computing its apportionable income for the tax year 1981, NCR excluded 100 percent of the gross foreign royalties and interest paid to NCR by its unitary foreign subsidiaries. On audit of the 1981 tax year, the South Carolina Tax Commission (hereinafter "Commission") included the foreign source royalties and interest in NCR's apportionable income and did not allow NCR to adjust the apportionment formula by adding to its ratios the property, payroll, and sales of its unitary subsidiaries.

In computing its apportionable income for tax years 1982 and 1983, NCR included foreign royalties and interest in its apportionable income but correspondingly increased the denominator of the apportionment formula by adding to its property, payroll, and sales the property, payroll, and sales of its foreign subsidiaries. On audit of the 1982 and 1983 tax years, the Commission removed from NCR's apportionment ratio the property, payroll, and sales of NCR's foreign subsidiaries. Such adjustment

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[2] NCR also receives substantial interest income from what NCR calls domestic source. NCR's Exhibit 14 identifies domestic source interest as follows:

1981	1982	1983
$17,959,824	$21,258,776	$25,109,476

was made since only NCR's income was being taxed, while none of the income of the subsidiaries was being taxed.

NCR disagreed with the Tax Commission's adjustments and paid $499,007 under protest. This action was then brought under Section 12-47-220.

ISSUES

Several issues were raised before this Court. However, after negotiations and discussions by the parties, four issues were removed.[3] There are three issues now remaining and each is discussed and decided in this Order.

I. Do South Carolina's Taxing Statutes Violate The Foreign Commerce Clause By Including In Apportionable Income Interest And Royalties Received From Its Unitary Foreign Subsidiaries?

After reviewing the evidence and arguments before the Court, the Court finds no violation of the Foreign Commerce Clause by any of South Carolina's taxing statutes challenged by NCR. In order to properly address the issue which is before the Court, an examination of South Carolina's statutes in light of the Foreign Commerce Clause is appropriate.

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[3] Issues which have been expressly withdrawn by the parties without prejudice to future litigation concerning later tax years not here in dispute are: (1) whether interest income from so-called "domestic sources" is apportionable or instead allocated to NCR's corporate headquarters in Ohio, (2) whether the sales factor of the apportionment formula should include in its denominator the entire gross receipts from a sale or should it include only the gain derived from the sale, (3) whether withholding tax paid to foreign countries is deductible under Section 12-7-700(4) as it existed for tax years 1982, 1983, and 1984, and (4) whether interest income identified as "I.R.C. 904(d) interest income" and "unrelated-party foreign interest income" is apportionable or instead allocated to Ohio as NCR's corporate headquarters. These issues are not before the Court and will not be addressed in this Order.

A. *Allocation to Foreign Countries*

South Carolina enacted Act 731 in 1958 to establish a system for determining how much of a taxpayer's income would be taxable in South Carolina. The statutory scheme imposes an income tax upon a base which reasonably represents the proportion of the trade or business carried on within South Carolina. *Hertz Corp. v. South Carolina Tax Commission*, 246 S.C. 92, 142 S.E.2d 445 (1965); *Lockwood Greene Eng. v. South Carolina Tax Commission*, 293 S.C. 447, 361 S.E.2d 346 (1987), and Section 12-7-250.

The base upon which South Carolina imposes its income tax is determined in two steps, both of which are identified in Article 9 of Title 12 as "Allocation or Apportionment of Income." The first step is allocation. Section 12-7-1120 explains that certain classes of income less related expenses are allocated, *i.e.*, taxed at a designated location.

In the instant case, NCR argues that its royalty and interest income should be allocated. NCR argues that the royalty and interest income in question was both earned in and taxed by the foreign jurisdictions and that, when such occurs, the Foreign Commerce Clause of the United States Constitution requires allocation of the income to those foreign countries.

NCR does not argue that the statutes of South Carolina require allocation. Rather, it asserts the tax imposed is unconstitutional since the Foreign Commerce Clause of the United States Constitution requires allocating to foreign countries the royalty and interest income. NCR asserts that to not allocate away such income "constitutes inevitable international multiple taxation and prevents the United States from speaking with one voice" in foreign commerce. The Court disagrees with these assertions and finds that no violation of Foreign Commerce results by not allocating to foreign countries the royalty and interest income here in dispute. The Court's

basis for this conclusion is developed more fully in "B" below since NCR makes the same Foreign Commerce arguments in asserting it is not required to apportion its royalty and interest income. The Tax Commission has argued that such income must be apportioned. It is this issue of apportionment that raises the second step of South Carolina's statutory scheme in determining the reasonable base of income subject to tax. Such is addressed below.

B. *Apportionment*

Apportionment is required by Section 12-7-1140, which states the following:

> "Net income of the above classes having been separately allocated, a taxpayer whose principal business in this State is (a) manufacturing or any form of collecting, buying, assembling, or processing goods and materials within this State, or (b) selling, distributing, or dealing in tangible personal property within this State, shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the arithmetical average of the three ratios stated in Sections 12-7-1150 to 12-7-1170."

After allocating specific classes of income less related expenses, NCR is subject to a formula that will determine the "proportion of its remaining net income" which is taxable in South Carolina. The formula is the average of three ratios: NCR's property in South Carolina as a percentage of NCR's property everywhere (*see* Section 12-7-1150); NCR's payroll in South Carolina as a percentage of NCR's payroll everywhere (*see* Section 12-7-1160); and NCR's sales in South Carolina as a percentage of NCR's sales everywhere (*see* Section 12-7-1170). The average of these three percentages is then multiplied by the remaining net income to give South Carolina apportionable income. NCR has challenged the apportionment statutes as being unconstitutional.

NCR argues that the apportionment formula is unconstitutional by its inclusion of royalty income and interest income from NCR's foreign subsidiaries. NCR argued before this Court that taxing such income violated the Foreign Commerce Clause on two grounds: such taxation creates inevitable multiple taxation and prevents the United States Government from "speaking with one voice" in regulating foreign commerce.[4] This Court finds no violation.

1. *No Inevitable Multiple Taxation Is Present*

Before there can be a finding that the apportionment formula "inevitably" creates multiple taxation, there must first be a finding that the royalty and interest income here in dispute have actually been subjected to multiple taxation by the formula. Such has not been shown here.

No showing of double taxation is present since such a view is premised on demonstrating that an identified

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[4] The taxpayer's grounds are based on the United States Supreme Court's tests for finding a violation of the Foreign Commerce Clause. The tests originated in a property tax context as follows:

> "In addition to answering the nexus, apportionment, and nondiscrimination questions posed in Complete Auto, a Court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation and, second, whether the tax prevents the federal government from 'speaking with one voice when regulating commercial relations with foreign governments.' If a state tax contravenes either of these precepts, it is unconstitutional under the commerce Clause. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 451."

Further, the first test of "substantial risk of international multiple taxation" has been altered for an income tax such as is before this Court. The test was modified to state that a "method of formula apportionment [that] 'inevitably' led to double taxation . . . might be reason enough to render it suspect." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 195, 103 S.Ct. 2933, 2955 (1983).

class of income is taxed by one party and that the same identified income is taxed by a second party. Here, the royalty and interest income was subject to tax under various treaties which allowed the income to be taxed by the "source nation," with the "source nation" being the place where the income originates.

South Carolina has not taxed the same royalty or interest income taxed by the foreign countries. Rather, South Carolina, in its apportionment formula, taxed only unitary income. Unitary income has no identifiable source but is merely a concept employed to determine what amount of income is properly "earned" in South Carolina. The mere fact that interest and royalty income are included in the preapportionment base does not mean that South Carolina is, in fact, taxing that specific income. Such a view was established in *Shell Oil Co. v. Iowa Dept. of Revenue*, 109 S.Ct. 278 (1988).

> ". . . . But income that is included in the preapportionment tax base is not, by virtue of that inclusion, taxed by the State. Only the fraction of total income that the apportionment formula determines (by multiplying the income tax base by the apportionment fraction) to be attributable to Iowa's taxing jurisdiction is taxed by Iowa. As our Commerce Clause analysis of apportionment formulas has made clear, the inclusion of income in the preapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation. *Shell, supra*, at p. 284."

Thus, in the instant case, there is, in fact, no double taxation shown.

The Court uses the term unitary income to mean NCR's income alone and not the combined income of NCR and its subsidiaries. NCR takes a different view. NCR agreed it is conducting a unitary business with its foreign subsidiaries, but it argued the royalty and interest

income in question is not a part of what it refers to as its unitary operating income (also referred to by NCR as its "combined income") which it argues is specifically earned and taxed in the foreign jurisdictions and should, therefore, be allocated to those foreign jurisdictions. The terms "combined income" and/or "unitary operating income" as applied by NCR mean the income which would result if NCR's subsidiaries were operated as Divisions of NCR and all corporations were combined into one single corporate entity.

NCR argued that royalty and interest income from its subsidiaries are not a part of what it refers to as its unitary operating income or combined income. NCR contends that royalty and interest income are not a part of its unitary operating or combined income because intercompany transactions eliminate them in a combined return. Although this contention is correct, it has no relevance to the case at hand. Whether or not the royalties and interest are eliminated in a combined return does not change NCR's tax liability, since South Carolina does not tax combined income.

The Tax Commission has used the term "unitary income" to mean NCR's income and not the combined income of NCR and its subsidiaries. The Loan Agreements and Patents employed and used in the foreign countries by NCR which earn the interest and royalties here in dispute are used in NCR's business. Further, the income from these Loan Agreements and Patents was used in the Taxpayer's business in the United States. The Commission argued the royalties and interest received by NCR from NCR's unitary subsidiaries were unitary with respect to NCR. The Court agrees with the view of the South Carolina Tax Commission.

While the Court finds there is no double taxation in fact, this Court further finds that even if double taxation could be established, there is no violation of the Foreign Commerce Clause since here it is established that any

such taxation is not "inevitable." This view is established in *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

Container, supra, held that in an income tax context multiple taxation occurs only in the sense that some of the income taxed by the foreign nations is part of the computation of the state's share of the unitary business. *Container,* 463 U.S. at 187. This so-called multiple taxation is not the inevitable result of South Carolina's apportionment formula but, rather, is the result of different jurisdictions applying different formulas of taxation. *Container, supra,* 463 at 189, found that multiple taxation under this circumstance is not fatal:

> ". . . such an absolute rule is no more appropriate here than it was in *Japan Line* itself, where we relied on much more than the mere fact of double taxation to strike down the state tax at issue. Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account *the context* in which the double taxation takes place *and the alternatives reasonably available to the taxing State.* (Emphasis added)."

NCR's multiple taxation argument rests on the faulty premise that multiple taxation of the same income in the international context is, per se, invalid under the Commerce Clause. NCR's argument ignores the "context" of such alleged multiple taxation and the "alternatives" available to South Carolina to eliminate any alleged multiple taxes.

South Carolina could eliminate one of the taxes by not taxing NCR's income at all. But, the "obvious unfairness" of such a rule "requires no elaboration", 463 U.S. at 190, 77 L.Ed.2d at 569, or South Carolina "could try to avoid double taxation by adopting some version of the " 'arms-length' approach" whereby foreign interest and royalties would be allocated, rather than apportioned,

but such a course "would not, by any means, guarantee an end to double taxation." *Ibid.* In this regard, "even though most nations have adopted the arms-length approach in its general outlines, the precise rules under which they reallocate income among affiliated corporations often differ substantially, and whenever that difference exists, the possibility of double taxation also exists." 463 U.S. at 191, 77 L.Ed.2d at 570. "Thus, even if [South Carolina] were to adopt some version of the arms-length approach, it could not eliminate the risk of double taxation of corporations subject to its [income] tax and might, in some cases, end up subjecting those corporations to more serious double taxation than would occur under formula apportionment." *Ibid.* It is the Court's finding that these conclusions of the *Container* court as to the impracticability of eliminating the so-called multiple taxation are equally applicable to NCR's foreign interest and royalties.

Further, it is the Court's view that multiple taxation of NCR's interest and royalties (which, admittedly, were received from unitary subsidiaries) cannot be established based on asserting that such income is taxed by a foreign country under a geographical arms-length approach to taxation. *Container*, 463 U.S. at 182, 77 L.Ed.2d at 564. The *Container* decision reiterated this position by its citations of *Mobil Oil Corp. v. Com. of Taxes*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510 (1980).

> ". . . separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.' Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is

not constitutionally required. 445 U.S. at 438, 100 S.Ct. at 1232 (citation omitted)." *Container, supra,* 463 U.S. at 181.

Further, this Court finds that NCR's multiple taxation argument leads to an anomalous result. Under NCR's view, the entire income of the foreign subsidiary could be constitutionally included in NCR's preapportioned net income base for purposes of computing taxable income on a combined report basis such as is used by states like California. However, a *lesser* amount of those same earnings, representing interest and royalties, could not be constitutionally included in NCR's preapportioned net income base if a State, like South Carolina, opts to use the unitary method upheld in *Mobil Oil.* It is unreasonable to subject South Carolina's unitary tax structure to more stringent Commerce Clause requirements, with respect to multiple taxation, than the *Container* court applied to the California combined report method. Had South Carolina employed the combined report method, NCR's multiple taxation argument would be foreclosed. It is improper for that argument to gain acceptance merely because South Carolina includes less than the full foreign subsidiary earnings in NCR's preapportioned unitary net income base.

For the above reasons, this Court finds no foreign commerce clause violation. *Container* is dispositive. As in *Container,* the situation in the instant case does not involve direct taxation of foreign subsidiary earnings but involves a tax upon NCR's South Carolina income-producing activities. NCR's argument of inevitable multiple taxation caused by South Carolina is incorrect.

2. ***No Interference With Federal Uniformity Is Present***

The second test relevant to a Foreign Commerce Clause analysis is whether the tax impairs federal uniformity in dealing with foreign commerce. Again, *Container, supra,*

has specifically found the standard three-factor formula for taxing income to be a proper method. *Container* explained as follows:

> "In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.' *Mobil*, 445 U.S. at 448, 100 S.Ct. at 1237. *See also Japan Line, supra*, 441 U.S. at 456, n. 20, 99 S.Ct. at 1825, n. 20; *Michelin Tire Corp., supra*, 423 U.S. at 286, 96 S.Ct. at 541. Thus, a state tax at variance with federal policy will violate the 'one voice' standard if it either implicates foreign policy issues which must be left to the Federal Government or violates a clear federal directive. The second of these considerations is, of course, essentially a species of preemption analysis."
>
> 103 S.Ct. at p. 2955.

Container found there was no hindrance to the federal government's authority to speak with "one voice." Further, there was no "clear federal directive" which is violated by the use of the three-factor formula. In light of the United States Supreme Court's specific and concrete holding on this identical issue, there can be no conclusion other than one finding no violation of the "one voice" test of Container.

II. Do South Carolina's Taxing Statutes Provide For An Adjustment to The Apportionment Formula?

NCR argues that including its foreign royalty and foreign interest in apportionable income requires adjustments to be made to the apportionment formula. The "adjustment" NCR seeks is to have the property, payroll, and sales of its foreign subsidiaries added to NCR's own property, payroll, and sales. The result of this adjustment is

that a smaller percentage would be applied to NCR's net income, giving a smaller South Carolina taxable net income. This Court finds that the statutes do not provide for such an adjustment.

The language of the statutes establishing the property, payroll, and sales ratio includes only the property, payroll, and sales of the single taxpayer, NCR, and not the combined ratios of NCR and its subsidiaries. Each statute uses the singular word "taxpayer" rather than the plural word "taxpayers."

> "The ratio of the average value of real estate and tangible personal property, as defined in this section, used by such *taxpayer* in this State during the income year, to the average value of the entire real estate and tangible personal property, as defined in this section, used by the *taxpayer* everywhere during the income year. . . .
>
> Section 12-7-1150 for property. (Emphasis added).
>
> The ratio of all salaries, wages, commissions, and other personal service compensation paid or incurred by the *taxpayer* in connection with the trade or business of the *taxpayer* in this State during the income year to the total salaries, wages, commissions, and other personal service compensation paid or incurred by the *taxpayer* in connection with the entire trade or business of the *taxpayer* wherever conducted during the income year. . . .
>
> Section 12-7-1160 for payroll. (Emphasis added).
>
> The ratio of sales made by such *taxpayer* during the income year which is attributable to this State to the total sales made by such *taxpayer* everywhere during the income year. . . ."
>
> Section 12-7-1170 for sales. (Emphasis added).

The word "taxpayer" is not ambiguous, and in the absence of an ambiguity, the language of a tax statute must

be given its plain, ordinary meaning. *Beach v. Livingston,* 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1966).

Emerson Electric Company v. Wasson, 287 S.C. 394, 339 S.E.2d 118 (1986), found that the sales ratio of Section 12-7-1170 was to be computed based on the separate sales of each taxpayer even when two corporations were filing together on a consolidated return. Thus, if the ratios must be computed separately for each corporation in a consolidated return, how much more must such be required in the instant case when NCR files as a single taxpayer? It cannot be emphasized too strongly that South Carolina is not taxing the net income of NCR's subsidiaries, whether they are foreign or domestic. Rather, South Carolina is taxing only the net income of NCR as a single corporate taxpayer. Since only NCR, as a single taxpayer, is being taxed, the statutes do not allow including NCR's foreign subsidiaries in calculating NCR's property, payroll, and sales.

NCR's argument that the ratios should include its subsidiaries' property, payroll, and sales has been rejected in two other jurisdictions. In Maryland, *NCR Corp. v. Comptroller of the Treasury,* 544 A.2d 764 (1988), the Court said:

> ". . . it is the taxpayer's property, sales, and payroll values, in Maryland and in total or everywhere, that enter the formula. 'The taxpayer' does not, of course, include the taxpayer's subsidiaries or their property, sales, and payroll values, just as the subsidiaries' income is not included. . . ."

Minnesota also rejected NCR's argument in *NCR Corp. v. Commissioner of Revenue,* 438 N.W.2d 86 (1989). There, the Minnesota Supreme Court stated:

> "Because NCR is the only 'taxpayer' involved in this case, the apportionment statute contemplates that only its factors of property used, payroll paid, and sales made are relevant for inclusion in the denominator of the apportionment function. Therefore,

> NCR's construction argument must be rejected. The Commission properly excluded sales made, payroll paid, and property used factors of [NCR's] foreign subsidiaries from the apportionment formula."

The language of South Carolina's apportionment statutes looks to the property, payroll, and sales of a single taxpayer, not those of NCR plus its subsidiaries. Further, the identical argument by NCR has been rejected by Maryland's and Minnesota's highest courts. Finally, *Emerson Electric, supra,* decided by our Supreme Court, requires the ratios to apply to only a single corporation and not to a combined group of corporations. Thus, this Court must reject NCR's argument.

III. Does The Lack Of An Adjustment To The Apportionment Formula Cause South Carolina's Formula To Be In Violation Of Due Process, Interstate Commerce, Or Foreign Commerce?

NCR argued that the United States Constitution is violated by South Carolina's statutes not including the foreign subsidiaries' property, payroll, and sales in computing NCR's South Carolina apportionable income. The argument is that failure to include these elements from the foreign subsidiaries violates Due Process, Interstate Commerce, and Foreign Commerce. This Court finds no violation.

A. *No Due Process Or Interstate Commerce Violation Occurs Under South Carolina's Statutes*

The test for determining whether an apportionment statute violates Due Process or Interstate Commerce is the same and has been clearly set out by the United States Supreme Court in *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159, 103 S.Ct. 2933 (1983). There, the following was established:

> ". . . an apportionment formula must, under both the Due Process and Commerce Clauses, be fair.

> *See Exxon Corp., supra,* 447 U.S. at 219, 227-228, 100 S.Ct. at 2118, 2122-2123; *Moorman Mfg. Co.,* 437 U.S. at 272-273, 98 S.Ct. at 2343-2344; *Hans Rees' Sons, Inc.,* 283 U.S. at 134, 51 S.Ct. at 389. The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not 'invalidat[e] an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State. . . .' *Moorman Mfg. Co., supra,* 437 U.S. at 272, 98 S.Ct. at 2344 (emphasis added). *See Underwood Typewriter Co.,* 254 U.S. at 120-121, 41 S.Ct. at 46-47. Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove 'by "clear and cogent evidence" that the income attributed to the State is, in fact, "out of all appropriate proportions to the business transacted . . . in that State," [*Hans Rees' Sons, Inc.*] 283 U.S. at 135, 51 S.Ct. at 389, or has "led to a grossly distorted result," [*Norfolk & Western R. Co. v. State Tax Comm'n.,* 390 U.S. 317, 326, 88 S.Ct. 995, 1001, 19 L.E.2d 1201 (1968)].' *Moorman Mfg. Co., supra,* 437 U.S. at 274, 98 S.Ct. at 2345."

South Carolina's statutes are not unconstitutional since the tests of internal consistency and external consistency are satisfied.

1. *Internal Consistency Is Satisfied*

The internal consistency test is satisfied if the taxing formula is such that, if applied by every jurisdiction, no more than all of the unitary income of the taxpayer would be taxed. In this case, South Carolina's statute, if adopted by everyone, would tax no more than 100% of NCR's income. This is true since the formula is based on the percentage of NCR's total property, payroll, and sales which is in each state. Under such a formula, it is impossible for there to be more than 100% of NCR's income taxed, since each state would use the same factors of property, payroll, and sales but would tax only that percentage of income based on property, payroll, and sales in that state. Minnesota, which has virtually the same three-factor formula as South Carolina, held that the three-factor formula was internally consistent in *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86, 1989 West Law 13846 (1989).

> "In our view, NCR has fallen far short of meeting its burden of demonstrating any internal inconsistency of Minnesota's apportionment formula. . . ."

South Carolina's three-factor formula is likewise internally consistent.

2. *External Consistency Is Satisfied*

The second test of a valid apportionment formula is whether the factors used in the apportionment formula reflect a reasonable sense of how income is generated.

> "The external consistency test asks whether the state has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed."
>
> *Goldberg v. Sweet*, 109 S.Ct. 582 (1989).

Does the three-factor formula reasonably reflect the in-state component of the overall activities of NCR? The United States Supreme Court has explicitly found the

three-factor formula is a reasonable and fair method for apportioning the unitary income of a taxpayer.

> "California and the other States that have adopted the Uniform Act use a formula—commonly called the 'three-factor' formula—which is based, in equal parts, on the proportion of a unitary business' total payroll, property, and sales which are located in the taxing State. *See* Cal. Tax & Rev. Code Ann., Sections 25128-25136 (West 1979). We approved the three-factor formula in *Butler Bros. v. McColgan,* 315 U.S. 501, 62 S.Ct. 701, 86 L.Ed. 991 (1942). Indeed, not only has the three-factor formula met our approval, but it has become, for reasons we discuss in more detail *infra,* at 2949, something of a benchmark against which other apportionment formulas are judged. *See Moorman Mfg. Co., supra,* at 282, 98 S.Ct. at 2349 (Blackmun, J., dissenting); *cf. General Motors Corp. v. District of Columbia,* 380 U.S. 553, 561, 85 S.Ct. 1156, 1161, 14 L.Ed.2d 68 (1965)."
>
> *Container Corp., supra, at* 103 S.Ct. 2943.

In fact, the Supreme Court, as recently as April 3, 1989, restated its conviction that the three-factor formula gives fair apportionment.

> "Nor has New Jersey imposed upon appellants an unfairly apportioned tax. New Jersey employs an apportionment formula that averages the percentages of in-state property, receipts, and payroll. *See* Part I-B, *supra.* We have expressly approved this apportionment formula in the past. *See, e.g., Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159, 170 (1983). Indeed, this three-factor formula has become . . . something of a benchmark against which other apportionment formulas are judged. *Ibid.*"
>
> *Amerada Hess Corp. v. Director, New Jersey Dept. of Treasury,* 109 S.Ct. 1617, 1989 W.L. 28807 (1989).

Since the three-factor formula is an approved apportionment method, NCR has the burden of demonstrating the apportionment is unfair.

> "We turn now to the question of fair apportionment. Once again, appellant has the burden of proof; it must demonstrate that there is 'no rational relationship between the income attributed to the State and the intrastate values of the enterprise,' *Exxon Corp.*, 447 U.S. at 220, 100 S.Ct. at 2118, quoting *Mobil, supra,* 445 U.S. at 437, 100 S.Ct. at 1231, by proving that the income apportioned to California under the statute is 'out of all appropriate proportion to the business transacted by the appellant in that State.' *Hans Rees' Sons, Inc.*, 283 U.S. at 135, 51 S.Ct. at 389."
>
> *Container Corp., supra,* 103 S.Ct. at 2948.

NCR has failed to demonstrate there is "no rational relationship between the income attributed to [S.C.] and the intrastate values of the enterprise."

The rational relationship between the income attributed to South Carolina and the intrastate values of NCR require determining three elements. First, what income is attributed to South Carolina; second, what are the activities of NCR in South Carolina; and finally, whether the activities in South Carolina are rationally related to the income taxed here.

The income which is taxed by South Carolina is NCR's unitary income. The interest and royalty income here in dispute resulted from intangible assets, specifically the Loan Agreements and Patents, employed in the Taxpayer's business in the foreign countries. Further, the income itself was used in the Taxpayer's business in the United States. The unitary income, by its very nature, cannot be identified as resulting from particular sources. Rather, unitary income reflects the efforts of profitability generated from numerous but unidentified sources.

The business activities NCR performs in South Carolina consist of the entire range of unitary activities. As the testimony reflected, NCR had two manufacturing plants in South Carolina, and NCR developed and marketed a line of computers from its West Columbia facility. Retail and service outlets are present throughout the state, and products produced in South Carolina are distributed worldwide. NCR also manufactures personal computers at its facility in Liberty, South Carolina.

Given the unitary nature of NCR's business and the extensive facilities generating property, payroll, and sales in South Carolina, such factors are rationally related to the activities producing the unitary income. Thus, the Court finds NCR has failed to show there is "no rational relationship" between the income South Carolina taxes and the three-factor formula used to determine South Carolina's percentage of NCR's unitary income.

Finally, as to the external consistency test, in addition to asserting there is no rational relationship between the South Carolina income and the South Carolina activities of NCR, the taxpayer has attempted to show the formula leads to apportioning income to an extent that is "out of all appropriate proportion to the business transacted by the appellant in that State." *Container Corp., supra,* at 2948. NCR has not shown this gross distortion.

Concerning distortion, our South Carolina Supreme Court in *Covington Fabrics v. South Carolina Tax Commission,* 264 S.C. 59, 202 S.E.2d 574, 577 (1975), held the following:

> "Although exactness in apportionment is desirable, all that is required is a reasonable approximation.
>
> 'Furthermore, this Court has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities such as those of appellant and has declared that "rough approximation rather than precision" is

> sufficient. *Illinois Central Ry. Co. v. State of Minnesota,* 309 U.S. 157, 161, 60 S.Ct. 419, 84 L.Ed. 670. Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an interstate privilege, this Court has not been willing to nullify honest state efforts to make apportionments.' *International Harvester Co. v. Evatt,* 329 U.S. 416, 67 S.Ct. 444, 91 L.Ed. 390, *reh. den.,* 329 U.S. 834, 67 S.Ct. 628, 91 L.Ed. 706."

The reluctance of the United States Supreme Court to conclude a formula created a gross distortion is established in *Butler Bros. v. McColgan,* 315 U.S. 501 (1942). There, a three-factor formula apparently caused a 1,500% increase in tax compared to the tax under the taxpayer's view. Despite this, the Court found the formula proper.

The Court notes that both Minnesota and Maryland were presented with this same argument by this same taxpayer. In both jurisdictions, the courts found NCR had no gross distortion caused by taxing royalties and interest.

After reviewing the evidence, this Court concludes there is no gross distortion present in this case sufficient to constitute a violation of Due Process. The Tax Commission presented evidence demonstrating that the total exclusion of all of what NCR identified as foreign royalties and foreign interest (thus, avoiding the alleged need for adjusting the apportionment factors) shows an average increase in taxes paid to South Carolina of 5.5%. On the other hand, NCR, using different methodology, presented evidence attempting to show an average increase in taxes paid to South Carolina of between 58.2% to 65.8%. This Court finds the Tax Commission's evidence correctly demonstrates the increase in tax due to excluding foreign royalties and interest. Such a minor difference as 5.5% is well within the limits of the Due Process requirements. In any event, the Court further

finds that even if a 65.8% increase could have been established, such is not a sufficient increase to violate Due Process or Interstate Commerce. All that is required is a "rough approximation rather than precision." *Covington Fabrics, supra.* This Court is satisfied that no Due Process or Interstate Commerce violation is created by South Carolina's apportionment statutes not including NCR's subsidiaries' payroll, property, and sales in NCR's apportionment factors.

B. *No Foreign Commerce Clause Violation Occurs By South Carolina's Statute Not Including The Payroll, Property, And Sales Of The Foreign Subsidiaries*

This Court has previously concluded that the inclusion in apportionable income of NCR's interest and royalty income is proper and such does not violate the foreign commerce clause. In its argument before this Court, NCR asserted that if its foreign interest and foreign royalties were included in apportionable income, then in order to avoid multiple taxation in violation of the Foreign Commerce Clause, adjustments to the payroll, property, and sales ratio were required. The adjustment sought is the inclusion of the payroll, property, and sales of the foreign subsidiaries as part of NCR's payroll, property, and sales.

This Court finds that the payroll, property, and sales of NCR's subsidiaries may not be added to NCR's payroll, property, and sales. First, such an adjustment is not authorized or allowed by South Carolina's statutes since only the factors of the single taxpayer, NCR, are utilized (see basis for this conclusion in II. of this Order). Second, no violation of the Foreign Commerce Clause occurs by limiting the apportionment factors to those of NCR and excluding those of the subsidiaries.

The test for determining if the Foreign Commerce Clause is violated by an apportionment formula as expressed earlier in this Order has been examined by *Con-*

tainer Corp., supra. There, the Court said two tests are relevant. First, is there an "inevitable risk of multiple taxation" by use of the formula; and second, does the tax "impair federal uniformity in an area where federal uniformity is essential?"

Container found the three-factor apportionment formula did not cause an inevitable risk of multiple taxation. The court found that even if actual double taxation were to occur, such was not absolutely forbidden. The court stated the following:

> "Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing state."
> 463 U.S. at 190, 103 S.Ct. at 2953.

The court then went on to say that no matter what formula the taxpayer used, it would still have a tendency to lead in some instances to double taxation.

> "Allocating income among various taxing jurisdictions bears some resemblance, as we have emphasized throughout this opinion, to slicing a shadow. In the absence of a central coordinating authority, absolute consistency, even among taxing authorities whose basic approach to the tax is quite similar, may just be too much to ask. If California's method of formula apportionment 'inevitably' led to double taxation, *see supra*, at 2952, that might be reason enough to render it suspect. But since it does not, it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation."
>
> 103 S.Ct. 2954-2955.

In the final analysis, *Container, supra,* held that since, in the international context, there is no practical means

to assure that double taxation will not occur, the use of the three-factor formula does not cause an inevitable risk of multiple taxation. Here, since South Carolina employs the same three-factor formula used by California, no Foreign Commerce Clause violation occurs.

Further, the second test of whether the tax would impair federal uniformity is likewise not violated by South Carolina's formula. In *Container*, the court explained as follows:

> "In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.' *Mobil*, 445 U.S. at 448, 100 S.Ct. at 1237. *See also Japan Line, supra*, 441 U.S. at 456, n. 20, 99 S.Ct. at 1825, n. 20; *Michelin Tire Corp., supra*, 423 U.S. at 286, 96 S.Ct. at 541. Thus, a state tax at variance with federal policy will violate the 'one voice' standard if it either implicates foreign policy issues which must be left to the Federal Government or violates a clear federal directive. The second of these considerations is, of course, essentially a species of preemption analysis.' "
>
> 103 S.Ct. at 2955.

The *Container* decision found that no foreign policy issues exclusively in the federal sphere were implicated by the three-factor formula. Likewise, no clear federal directive was violated by the three-factor formula. Further, this Court notes that Minnesota, in *NCR Corp. v. Commissioner of Revenue, supra*, reviewed the same argument and found no Foreign Commerce violation was found. Likewise, this Court finds no violation occurs under South Carolina's virtually identical three-factor formula.

Based on the foregoing, it is the Order of this Court that the tax payment of $499,007 paid under protest by NCR is not to be refunded.

AND IT IS SO ORDERED.

/s/ Thomas L. Hughston, Jr.
THOMAS L. HUGHSTON, JR.
Presiding Judge
Fifth Judicial Circuit

February 22, 1989.

APPENDIX F

STATE OF SOUTH CAROLINA
BEFORE THE
SOUTH CAROLINA TAX COMMISSION

IN RE:

A FINDING CONCERNING THE INCOME TAX LIABILITY OF NCR CORPORATION FOR TAX YEARS 1981, 1982 AND 1983 AND LICENSE FEE LIABILITY FOR 1982, 1983 AND 1984.

[Filed January 22, 1988]

FINDINGS OF FACT

NCR manufactures and sells business machines, equipment and related supplies. It has its principal place of business and corporate headquarters in Dayton, Ohio. NCR has sales and service offices in South Carolina as well as a substantial manufacturing plant located in the state.

NCR has developed a worldwide market for its products by use of foreign subsidiaries. Each subsidiary enters into a licensing agreement whereby NCR allows each subsidiary the right to manufacture and sell business machines and equipment patented by NCR. NCR provides the subsidiaries with all research, engineering, patentable and unpatentable know-how and trade secrets. NCR also makes substantial loans to the subsidiaries. In return the subsidiaries pay interest on the loans and pay as a royalty a percentage of the gross sales by the subsidiary of licensed NCR products. After an audit the matter has been presented to us.

CONCLUSION

Four issues are present. First, since South Carolina has taxed NCR's royalty and interest income, must South Carolina include the subsidiaries' payroll, property and

sales in the denominator when computing the three factor formula for apportioning NCR's income? Second, is the interest income from loans and investments subject to being apportioned or is such allocated? Third, are gains on the sales of foreign exchange contracts part of the denominator in computing the sales ratio? Finally, did the Field Services Division improperly deny a deduction for taxes paid by NCR? Each of these issues is addressed below. We are unable to agree with NCR's positions.

1. *Subsidiaries' Payroll, Property & Sales*

The apportionment statutes in South Carolina tax only the taxpayer's income "which reasonably represents the proportion of the trade or business carried on within this state." Section 12-7-250. See also *Hertz Corp. v. South Carolina Tax Com'n.*, 246 S.C. 92, 142 S.E.2d 445 (1965). That base is found by applying Article 9 of Chapter 7 in Title 12. Under that Article a taxpayer's royalty income is apportioned for a taxpayer conducting a business like NCR's based upon "the arithmetical average of the three ratios stated in Sections 12-7-1150 to 12-7-1170." Section 12-7-1140. The ratios are based upon the taxpayer's property, payroll and sales in this state compared to the taxpayer's property, payroll and sales everywhere. The taxpayer the statute is concerned with is the single corporation, not the corporation plus its subsidiaries. Here South Carolina is taxing only NCR's income and is not taxing the income of NCR's subsidiaries. NCR is a separate taxpayer from its subsidiaries and thus only NCR's property, payroll and sales are considered. We thus find and conclude the payroll, property and sales of NCR's subsidiaries do not enter into the ratios for computing NCR's South Carolina income.

We further find and conclude that not including the property, payroll and sales of NCR's subsidiaries does not violate due process requirements. Due process requires that there be a minimal connection between the interstate activities and the taxing state and that there exist a ra-

tional relationship between the income attributed to the state and the intrastate values of the enterprise. *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 436-437 (1980). The nexus with South Carolina is readily found from NCR's sales, service and manufacturing activities in South Carolina. The rational relationship between the income taxed and the intrastate values of NCR are satisfied by application of South Carolina's three factor formula. This formula does not violate due process so long as it does not attribute income to South Carolina out of all appropriate proportions and is not a grossly distorted result. *Moorman Manufacturing Co. v. Bair,* 437 U.S. 267, 274 (1978). We find there is no gross distortion from South Carolina's application of the three factor formula.

2. *Interest Income Apportioned.*

The question here is whether the interest income in dispute is allocated under Section 12-7-1120(1) or apportionable under Section 12-7-1140. Section 12-7-1120(1) provides as follows:

> "(1) Interest received by the taxpayer from intangible property not connected with the business of the taxpayer and all interest from intangible property of domestic insurance companies less all related expenses shall be allocated to the state in which the principal place of business of a corporation taxpayer is located or in which the domicile of an individual taxpayer is located."

Section 12-7-1120(1) allocates interest income only if the intangible property that produced the interest income is "not connected with the business of the taxpayer". The assets that generated the interest income are connected to NCR's business. The funds used to produce the interest income were from the sale of business machines. The funds are in the nature of short term investments readily available for use in NCR's business. Much

of the interest income resulted from loans to subsidiaries that enable the subsidiaries to sell business machines produced by NCR. It appears that NCR did not segregate the interest income from its general revenue from the sale of business machines but rather commingled the income. In short, the proceeds of the investments were available for the business needs of NCR. We find the loans that generated the interest are connected with NCR's business and thus the interest income in dispute is properly apportioned and may not be allocated. See *Texaco v. Wasson*, 269 S.C. 255, 237 S.E.2d 75, 80 (1977) and *Lone Star Steel Company v. Dolan*, 668 P. 2d 916 (1983).

3. *Sales of Foreign Exchange Contracts*

The Division has included in the denominator of the sales factor gain resulting from the disposition of the exchange contracts. We find such to be proper. This position has been the practice of the Tax Commission since 1977 and is a longstanding administrative position. Such should not be overturned unless cogent reasons for doing so are found. *Emerson Electric Co. v. Wasson*, 287 S.C. 394, 339 S.E.2d 118 (1986). We find no cogent reasons to change the practice. It must be noted that the apportionment formula need not be an exact measure of the taxpayer's business activity but rather must only provide a reasonable approximation. *Covington Fabrics v. South Carolina Tax Commission*, 264 S.C. 59, 212 S.E.2d 574 (1975). Here inclusion of the gain from the foreign exchange contracts provides a reasonable apportionment approach.

4. *Deductibility Of Withholding Taxes*

NCR receives royalty payments and interest payments from its foreign subsidiaries. The foreign countries in which the subsidiaries operate require that a withholding of tax be made on the subsidiaries' payments to the parent. The tax withheld is based upon the fact that the subsid-

iaries generated income. We find the deduction of this tax is prohibited by Section 12-7-700(4). That section denies a deduction for taxes paid based upon a taxpayer's income. Since the tax here is with respect to income, no deduction is proper.

AND IT IS SO FOUND AND ORDERED.

SOUTH CAROLINA TAX COMMISSION

/s/ S. Hunter Howard, Jr.
S. HUNTER HOWARD, JR.
Chairman

/s/ John M. Rucker
JOHN M. RUCKER
Commissioner

/s/ A. Crawford Clarkson, Jr.
A. CRAWFORD CLARKSON, JR.
Commissioner

Columbia, South Carolina

January 22, 1988

APPENDIX G

SOUTH CAROLINA STATUTES INVOLVED*

Sec. 12-7-230. Tax on corporations.—(A) Every corporation organized under the laws of this State, whose entire business is transacted or conducted within this State, shall make a return and shall pay annually an income tax equivalent to five percent of the entire net income received by such corporation during the income tax year, and except as otherwise provided, every corporation organized under the laws of this State, doing or transacting business partly within and partly without this State, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income to be determined as provided in this chapter, and except as otherwise provided, every foreign corporation transacting, conducting, doing business or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income, to be determined as provided in this chapter. The term "*transacting,*" "*conducting,*" or "*doing business,*" as used in this section shall include the engaging in or the transacting of any activity in this State for the purpose of financial profit or gain.

(B) In the case of any corporate taxable year beginning before January 1, 1989, the rate imposed by subsection (A) does not apply and the following rates apply:

(1) six percent for corporate taxable years beginning before 1988,

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* With the exception of § 12-7-600, the statutes in effect for the years at issue (1981-83), which were amended over the years in minor respects having no bearing on the controversy before this Court, are substantially similar to the current statutes, reproduced herein.

(2) five and one-half percent for corporate taxable years beginning in 1988.

Sec. 12-7-600. "Net income" defined.—The words "net income" as used in this chapter mean the gross income of a taxpayer less the deductions allowed by this chapter.

Sec. 12-7-1120. Allocation of interest, dividends, patent and copyright royalties, rents, gains and losses, and income from personal services.—The following items of income shall be specifically and directly allocated in accordance with the following provisions before apportionment of the remaining net income, and such items shall not be included in any factor of the apportionment formula:

(1) Interest received by the taxpayer from intangible property not connected with the business of the taxpayer, and all interest from intangible property of domestic insurance companies less all related expenses, shall be allocated to the state in which the principal place of business of a corporation taxpayer is located, or in which the domicile of an individual taxpayer is located.

(2) Dividends received from corporate stocks owned, less all related expenses, shall be allocated to the state in which the principal place of business of a corporation is located or in which the domicile of an individual taxpayer is located.

(3) Rents received from the lease or rental of real estate or tangible personal property, royalties received from tangible property, where the property leased or rented was not used in or was not connected with the trade or business of the taxpayer during the income year, less all related expenses, shall be allocated to the state in which the property was located at the time the income was derived.

(4) Gains and losses from the sale of real property located in this State are allocable to this State, and the

gains and losses from the sale of real property located outside this State shall be allocated to the state in which the real property is located.

(5) Gains and losses from sales of intangible personal property not connected with the business of the taxpayer other than any intangible personal property held for sale to customers in the regular course of business, less all related expenses, shall be allocated to the state of a corporation taxpayer's principal place of business, or of an individual taxpayer's domicile.

(6) All income from personal services received by a resident individual shall be allocated to this State. All income from personal services received by a nonresident individual for services rendered in this State shall be allocated to this State.

Sec. 12-7-1130. Allocation of income from any other investments.—The income less all related expenses from any other investments, including investments in subsidiaries, the net income from which is not properly includable in the net apportionable income of corporations engaged in interstate commerce under the Constitution of the United States because it is unrelated to the business activity of the corporation conducted partly within and partly without South Carolina, shall be allocated to the state in which the business situs of the investment is located; *provided*, that if the business situs of such investment is partly within and partly without South Carolina, it shall be apportioned by use of the same formula as provided for apportioning the net income of the corporation.

Sec. 12-7-1140. Remaining income of certain manufacturers, processors, dealers and others.—Net income of the above classes having been separately allocated, a taxpayer whose principal business in this State is (a) manufacturing or any form of collecting, buying, assembling or processing goods and materials within this State, or

(b) selling, distributing or dealing in tangible personal property within this State, shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the arithmetical average of the three ratios stated in §§ 12-7-1150 to 12-7-1170.

Sec. 12-7-1150. Remaining income of certain manufacturers, processors, dealers, and others; ratio for property.—(1) The ratio of the average value of real estate and tangible personal property, as defined in this section, used by such taxpayer in this State during the income year, to the average value of the entire real estate and tangible personal property, as defined in this section, used by the taxpayer everywhere during the income year. . . .

Sec. 12-7-1160. Remaining income of certain manufacturers, processors, dealers and others; ratio for payrolls.—The ratio of all salaries, wages, commissions and other personal service compensation paid or incurred by the taxpayer in connection with the trade or business of the taxpayer in this State during the income year to the total salaries, wages, commissions and other personal service compensation paid or incurred by the taxpayer in connection with the entire trade or business of the taxpayer wherever conducted during the income year . . . .

Sec. 12-7-1170. Remaining income of certain manufacturers, processors, dealers and others; ratio for sales.—The ratio of sales made by such taxpayer during the income year which are attributable to this State to the total sales made by such taxpayer everywhere during the income year . . . .

Sec. 12-19-70. Imposition of license tax on corporations generally; rate; minimum tax; time payable.—In addition to all other license taxes or fees or taxes of whatever kind, every corporation required to file the report

by Section 12-19-20 except the corporations enumerated in Section 12-19-100, shall pay to the Commission at the time of filing the report as required by Section 12-19-20 an annual license fee of fifteen dollars plus one mill on each dollar paid to the capital stock and paid in as surplus of the corporation as shown by the records of the corporation on the first day of the income year next preceding the date of filing the report. In no case may the license fee provided by this section be less than twenty-five dollars. The license fee provided for by this section must be paid at the time of filing the report pursuant to the provisions of Section 12-19-20. The phrase "*paid in as surplus*" for the purposes of Chapter 19, Title 12, means the entire surplus of a corporation other than its earned surplus as defined below, and includes any charges against earned surplus reflected in the balance sheet except charges for reserves.

For purposes of this section, "*earned surplus*" means that portion of the surplus of a corporation equal in amount to the balance of its net profits, income, gains, and losses from the date of incorporation, or from the latest date when a deficit was eliminated by application of its capital surplus, after deducting subsequent distributions to shareholders and transfer to stated capital and capital surplus to the extent that such distribution and transfers are made out of earned surplus. Unrealized appreciation of assets shall not be included in earned surplus.

Sec. 12-19-80. Proration of tax where business is conducted partly without the State.—Where a corporation does business in part within this State and in part without this State, or uses a part of its capital within this State and uses a part of its capital without this State, or owns, maintains or operates one or more establishments or plants within this State and owns, maintains or operates one or more establishments or plants without this State, the amount of the license fee provided for in § 12-19-70 shall

be measured by a proportion of the dollars paid to the capital stock and paid in as surplus of the corporation, determined in accordance with the ratios prescribed for purposes of the income tax as set forth in §§ 12-7-1140 to 12-7-1170 and 12-7-1190.

For the purposes of this section the ratios to be used shall be based upon the accounting period of the corporation as regularly established for the purposes of the income tax.